

proportional mark-up above costs on wholesale services as on its retail services.<sup>2147</sup> The formula sets the ratio of total revenue less total expenses to total revenue (retail markup) equal to the ratio of wholesale revenue less wholesale expenses to wholesale revenues (allowable wholesale markup) then computes wholesale revenue (and rates) by solving for that variable in a simple equation.<sup>2148</sup> MCI computes a wholesale discount rate as one minus the ratio of wholesale revenue over total revenue. Wholesale rates are computed by reducing retail rates by the wholesale discount.

893. MCI proposes that states use its model to calculate a single wholesale discount rate for each incumbent LEC that would apply in every state in which that incumbent LEC does business and for all services the incumbent LEC provides for resale. States would apply that rate to each of the incumbent LECs' retail services. For the seven BOCs and GTE, MCI's calculated wholesale discount factors range from 25 to 35 percent.<sup>2149</sup> MCI suggests that its study be declared presumptively valid by the Commission, but suggests that the Commission allow states to adopt a different resale discount by showing that the model does not produce an accurate result.<sup>2150</sup>

894. Sprint, several incumbent LECs, and potential facilities-based entrants, criticize the MCI model. Lincoln Telephone faults the underlying MCI study for relying on a sample of only eight companies, arguing that the limited sample does not capture the variety of

$$^{2147} \text{ Wholesale Price Discount} = 1 - \frac{\text{Wholesale Service Revenue}}{\text{Total Operating Revenue}}$$

Where:

$$\text{Wholesale Service Revenue} = \frac{\text{Total Wholesale Expenses}}{(1 - \text{Base Margin})}$$

$$\text{Total Wholesale Expenses} = \text{Total Operating Expenses} - \text{Total Avoided Costs}$$

$$\text{Base Margin} = \frac{\text{Total Operating Revenue} - \text{Total Operating Expenses}}{\text{Total Operating Revenue}}$$

$$^{2148} \frac{\text{Retail Revenue} - \text{Total Expenses}}{\text{Retail Revenue}} = \frac{\text{wholesale revenue} - (\text{total expenses} - \text{avoided expenses})}{\text{wholesale revenue}}$$

$$\text{Wholesale Revenue} = \text{Retail Revenue} - \left[ \text{Avoided expenses} \times \frac{\text{Retail Revenue}}{\text{Total Expenses}} \right]$$

This is as compared to: Wholesale Revenue = Retail Revenue - Avoided Expenses

<sup>2149</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 12.

<sup>2150</sup> MCI comments at 90.

billing, costing and collecting arrangements of all existing carriers.<sup>2151</sup> Several incumbent LECs, although not criticizing the MCI study specifically, oppose any approach that utilizes USOA accounts,<sup>2152</sup> or calculates the resale discount by deducting avoidable, as opposed to actually avoided, costs.<sup>2153</sup> Others attack MCI's method of computing wholesale rates once avoided costs are measured.<sup>2154</sup> MFS argues that there is no statutory basis for MCI's use of a formula that removes the markup associated with avoided retail expenses from the retail rates.<sup>2155</sup>

895. AT&T's avoided cost model is similar to MCI's model in that it is an embedded cost approach that starts with publicly-available accounting data.<sup>2156</sup> AT&T's model, however, involves several additional layers of calculations. The model assigns incumbent LEC Automated Record Management Information Systems (ARMIS) revenue and expense data to five lines of business (units). For the local business unit, which it uses as the applicable unit for resale under section 251(c)(4), avoidable expenses are computed by USOA account. AT&T argues that all of the costs associated with the following USOA accounts categories should be excluded as avoided costs, many of which are summary accounts and subsume a set of other accounts:

- Account 5300 (uncollectibles)
- Account 6220 (operator systems expense) (if appropriate)
- Account 6533 (testing expense)
- Account 6534 (plant operations administration expense)
- Account 6610 (marketing expense)
- Account 6620 (customer service expense)

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<sup>2151</sup> Lincoln Tel. comments at 8-9.

<sup>2152</sup> See, e.g., BellSouth reply at 41; PacTel reply at 45-46.

<sup>2153</sup> See, e.g., SBC reply at 15; NYNEX reply at 40; Ameritech reply at 37-39.

<sup>2154</sup> MFS reply at 36.

<sup>2155</sup> *Id.* This was also a point debated by incumbent LECs in various state proceedings. See, e.g., *Petition for a Total Local Exchange Wholesale Service Tariff from Illinois Bell Telephone Company*, Nos. 95-0458 and 95-0531 (consol.) (Illinois Commission June 26, 1996) at 5-20. Teleport argues that the Illinois Commission's decision to include a portion of profit contribution was incorrect. Teleport comments at 59.

<sup>2156</sup> AT&T reply at Appendix E (Avoided Cost Model).

AT&T further argues that the portion of the following USOA accounts associated with the incumbent LEC's retail operations should be excluded as avoided costs:

- Account 6110 (network support expense)
- Account 6120 (general support expense)
- Account 6560 (depreciation expense)
- Account 6710 (executive and planning expense)
- Account 6720 (general and administrative expense)
- Account 7240 (operating other taxes)
- Account 7540 (other interest deductions)

AT&T also recommends partial avoidance of "Total Returns," which refers to portions of the retail rate that contributes to an incumbent LEC's earnings. Ultimately, under AT&T's model, the sum of avoided direct and indirect retail costs is divided by the local service-related revenues to derive the avoided cost discount. AT&T applies its model to each state, with the exception of Alaska, and derives discount rates that range from 23 percent to nearly 56 percent. Parties did not have an opportunity to comment specifically on the AT&T model during the pleading cycle of this proceeding because it was submitted with AT&T's reply. However, AT&T identified in its initial comments the list of fully and partially avoided USOA accounts that were ultimately used in its model. Criticisms of these classifications of fully and partially avoided costs are discussed below.

896. Sprint submits a sample study of its LEC subsidiary operations in Tennessee as an example of how the avoided cost approach advocated by Sprint would be applied.<sup>2157</sup> It was undertaken at the request of the Tennessee Commission to be used under the 1996 Act for calculating wholesale costs. Specifically, the study examines rates for resale of bundled services, focusing on those categories of costs defined in the 1996 Act (marketing, billing, collection, and other costs). Sprint describes its study as employing an activity-based cost approach that identifies the avoided cost by cost category and assigns these costs to service groups, based on a computed factor that assigns each specific type of expense to the activity that creates or drives that expense. Sprint does not provide the worksheets detailing this cost assignment because Sprint considers the worksheets to be proprietary. Costs are identified at the subaccount level. Sprint computes the percentage of avoided costs of providing simple access service at wholesale as a percentage of simple access revenue to be 4.76 percent. Sprint computes a 7.19 percent figure for other services. In its reply comments, Sprint suggests that the AT&T and MCI models significantly overstate incumbent LEC avoided costs.

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<sup>2157</sup> Sprint comments at Appendix C (Avoided Cost Study: Tennessee United Telephone--S.E., Inc.).

897. Parties also commented on the specific USOA accounts that should be used to identify avoided costs. We summarize below the comments with respect to the various accounts:

*Marketing expenses--Account 6611 (product management), Account 6612 (sales), and Account 6613 (product advertising):*

Resellers and most IXC's, other than Sprint, all support identification of these accounts as completely avoidable, both because they are explicitly mentioned in the 1996 Act and because these expenses would not be necessary in a wholesale operation.<sup>2158</sup> Incumbent LECs, Sprint, MFS, and Time Warner argue that expenses recorded in these accounts would, in fact, be incurred in connection with the provision of wholesale services such as marketing to wholesalers.<sup>2159</sup>

*Services expenses--Account 6621 (call completion services), Account 6622 (number services), and Account 6623 (customer services):*

IXCs and resellers contend that all of the expenses recorded in these accounts should be treated as avoidable costs because a reseller will either purchase these services separately or provide them itself.<sup>2160</sup> Incumbent LECs and Sprint argue that these services have no relation to local retail service and therefore cannot be included in avoided costs used to compute wholesale local service rates.<sup>2161</sup>

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<sup>2158</sup> See, e.g., Cable & Wireless comments at 46 n.77; Telecommunications Resellers Ass'n comments at 25-26; AT&T comments at 84 n.130; CompTel comments at 96-97; MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 5-6.

<sup>2159</sup> See, e.g., Ameritech reply at 38; Bell Atlantic reply at 23; GTE reply at 25 n.40; MFS reply at 35; Time Warner reply at 21; USTA reply at 30; Sprint reply at 38.

<sup>2160</sup> See, e.g., AT&T comments at 84 n.130; MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 6; Cable & Wireless comments at 46 n.77; Telecommunications Resellers Ass'n comments at 25-26. CompTel states that such accounts should be avoided where appropriate. CompTel comments at 96-97.

<sup>2161</sup> See, e.g., Bell Atlantic reply at 23 (with respect to account 6623); USTA reply at 30 (account 6623 includes costs devoted to customer service relating to interexchange service); Sprint reply at 38-39 (also identifies account 6623 as relating to separately billed services). PacTel agrees that costs of directory assistance call allowances, directory listing, and telephone directories will continue to be incurred. PacTel reply at 46.

*Information origination/termination expenses and other property, plant and equipment expenses--Account 6341 (large PBX expense), Account 6351 (public telephone terminal equipment expense), Account 6511 (property held for future telecommunications use), and Account 6512 (provisioning expense):*

MCI and Cable & Wireless identify accounts 6341 (large PBX expense), 6351 (public telephone terminal equipment expense), 6511 (property held for future telecommunications use) and 6512 (provisioning expense) as completely avoidable,<sup>2162</sup> while incumbent LECs, MFS and Sprint argue that these expenses are not associated with retail activities.<sup>2163</sup>

*Account 6220 (operator systems expense):*

AT&T, TCC, and GCI argue that this account is wholly avoidable where resellers choose not to purchase operator services<sup>2164</sup> while Sprint argues that the account is unrelated to local service.<sup>2165</sup>

*Account 6790 (provision for uncollectible notes receivable)/5300 (uncollectible revenue):*

AT&T, TCC, and GCI argue that the sum recorded in account 5300 represents a revenue offset that is wholly avoidable.<sup>2166</sup> MCI chooses to measure uncollectibles using account 6790, arguing that expenses in this account are partially avoidable.<sup>2167</sup> Sprint and Time Warner disagree with the contention that uncollectibles are avoidable at all, claiming that uncollectibles may actually increase in a wholesale operation.<sup>2168</sup>

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<sup>2162</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 8; Cable & Wireless comments at 46 n.77.

<sup>2163</sup> MFS reply at 35-36; Sprint reply at 38; GTE reply at 25 n.40 (at least with respect to accounts 6341 and 6351).

<sup>2164</sup> AT&T reply at Appendix E (Avoided Cost Model); TCC comments at 45 n.45; GCI comments at 1.

<sup>2165</sup> Sprint reply at 38.

<sup>2166</sup> AT&T comments at 84 n.130; AT&T reply, Appendix E (Avoided Cost Model); TCC comments at 45 n.45; GCI comments at 1.

<sup>2167</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 9.

<sup>2168</sup> Sprint reply at 37; Time Warner reply at 21.

*Network support expenses (Accounts 6112-6116):*

AT&T, TCC, GCI, and the Telecommunications Resellers Association assert that all of these accounts are partially avoidable.<sup>2169</sup> MCI only discusses account 6113 (aircraft expense), identifying it as completely avoidable because it is not related to wholesale services.<sup>2170</sup> Sprint and MFS disagree, arguing that there is no evidence that costs in these accounts will decrease with wholesale offerings because these expenses will have to continue to be incurred.<sup>2171</sup>

*General support expenses (Accounts 6121-6124) and Account 6711 (executive), Account 6712 (planning), and Accounts 6721-6728 (general and administrative expenses):*

Resellers and IXC's contend that the shared expenses recorded in these accounts are partially avoidable.<sup>2172</sup> MCI and Cable & Wireless identify accounts 6722 (external relations) and 6727 (research and development) as completely avoidable.<sup>2173</sup> MCI argues that overhead costs support all of the activities, including the activities that are avoided when services are sold at wholesale. Therefore, according to MCI, a portion of overhead expenses must be treated as avoided cost.<sup>2174</sup> AT&T argues that wholesaling will necessarily lead to an overall reduction in the size of an incumbent LEC's operations and thus to a reduction in shared expenses.<sup>2175</sup> Sprint and Time Warner argue that there is no evidence to support a conclusion that resale will lead to a general reduction in shared expenses.<sup>2176</sup>

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<sup>2169</sup> AT&T comments at 84 n.131; TCC comments at 46 n.46; GCI comments at 1; Telecommunications Resellers Ass'n comments at 25-26.

<sup>2170</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 8.

<sup>2171</sup> MFS reply at 35 (only discusses account 6113); Sprint reply at 39-40.

<sup>2172</sup> See, e.g., Telecommunications Resellers Ass'n comments at 25-26; AT&T comments at 84 n.131.

<sup>2173</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 6-7; Cable & Wireless comments at 47 n.79.

<sup>2174</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 9.

<sup>2175</sup> AT&T reply, Appendix E (Avoided Cost Model) at 2.

<sup>2176</sup> Sprint reply at 39-40; Time Warner reply at 21

*Depreciation and amortization expenses (Accounts 6561-6565) and operating taxes (Accounts 7220-7240):*

Resellers and IXC's also argue to varying degrees that such expenses are partially avoidable.<sup>2177</sup> MCI and Cable & Wireless argue for the complete avoidance of accounts 6562 (depreciation expense--property held for future telecommunications use) and 6564 (amortization expense--intangible).<sup>2178</sup> MFS, Sprint, and Time Warner argue that these costs will continue to be incurred for wholesale operations.<sup>2179</sup>

*Other partially avoided accounts:*

AT&T, TCC, and GCI argue that accounts 6533 (testing expenses), 6534 (plant operations administration expense), and 7540 (other interest), and total returns are partially avoidable<sup>2180</sup> while Sprint disagrees.<sup>2181</sup>

#### 4. State Decisions

898. Several state commissions have already made interim or final determinations with respect to wholesale rates. Some, like the California and Maryland commissions, did not purport to apply or interpret the 1996 Act. Others, including the Illinois and Georgia commissions, explicitly applied section 252(d)(3) in reaching their decisions. Post-1996 Act state decisions announced to date are summarized below.

899. *California:* The California Commission adopted interim rules, effective March 31, 1996, for the resale of local exchange services by competitive LECs within the areas served by Pacific and GTE.<sup>2182</sup> Although the record in that proceeding was closed before the

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<sup>2177</sup> See, e.g., Telecommunications Resellers Ass'n comments at 25-26; AT&T comments at 84 n.131; CompTel comments at 97.

<sup>2178</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 9; Cable & Wireless comments at 47 n.79.

<sup>2179</sup> MFS reply at 35-36 (account 6564 is not related to retail); Sprint reply at 39-40; Time Warner reply at 21.

<sup>2180</sup> AT&T comments at 84 nn.130-31; TCC comments at 46 n.46; GCI comments at 1. Sprint does not comment on account 7540.

<sup>2181</sup> Sprint reply at 39-40.

<sup>2182</sup> Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service, R. 95-04-043 and I. 95-04-044 (California Commission April 26, 1996). Although the final order was not issued until April 26, 1996, it became effective March 31, 1996.

passage of the 1996 Act, the California Commission applied a "retail rates minus avoided cost" standard similar to that contained in section 252(d)(3) for purposes of setting interim rates. The California Commission used an embedded cost study and USOA accounting data to calculate business discounts rates of 17 percent for PacTel and 12 percent for GTE. Because it had previously found that residential rates were already below direct embedded cost, the California Commission applied to residential services a reduced discount rate of 10 percent for PacTel and 7 percent for GTE. In arriving at this conclusion, the California Commission considered uncollectibles, marketing, and customer service expenses to be partially avoidable, to varying degrees.

900. *Colorado*: The Colorado Commission established a business discount rate of 16 percent and a residential discount rate of 9 percent.<sup>2183</sup> Using Colorado-specific embedded cost information previously filed by U S West as part of an annual report to that commission, the Colorado Commission calculated avoided costs for five categories of services. The Colorado Commission treated the following costs as totally avoided: uncollectibles; direct expense associated with operator services; customer operations (product management, sales, and product advertising); call completion; and number services. The Colorado Commission also considered 95 percent of the costs of customer services to be avoidable. General purpose computer expense and related depreciation, and general corporate overheads, were treated as partially avoided. The Colorado Commission concluded that wholesale discounts should be as follows: residential, 9 percent; business, 16 percent; toll services, 30 percent; central office-based features, 50 percent; all other services, 18 percent.

901. *Georgia*: The Georgia Commission established a 20.3 percent discount rate for wholesale residential service and a 17.3 percent discount rate for wholesale business service.<sup>2184</sup> The Georgia Commission used embedded cost information to calculate avoided direct expenses. The Georgia Commission also found that a percentage of general support, administrative, and corporate operations expenses should be considered avoided costs. In computing its final discounts, the Georgia Commission apportioned total avoided expense between residential and business services according to BellSouth's revenues for the two categories. Prior to such apportionment, the Georgia Commission's discount was 18.74 percent.

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<sup>2183</sup> *U S West Communications, Inc. Filing Advice Letter No. 2610 in Compliance with Commission Decision No. C96-521 Adopting Emergency Rules*, Docket No. 96S-233T (Colorado Commission June 21, 1996).

<sup>2184</sup> *Petition of AT&T for the Commission to Establish Resale Rules, Rates, Terms, and Conditions and Initiate Unbundling of Services*, Docket No. 6352U (Georgia Commission June 21, 1996).

902. *Illinois*: The Illinois Commission released an order on June 26, 1996, setting wholesale discount rates for Ameritech and Centel local exchange services.<sup>2185</sup> The Illinois Commission applied the section 252(d)(3) pricing standard, but rejected use of embedded cost studies as inconsistent with the Commission's established cost of service rules. Instead, the Illinois Commission based its analysis on a methodology that begins with retail rates, then subtracts: (1) the "total assigned cost" of retail functions; and (2) a *pro rata* share of contribution attributable to the avoided retail costs. Total assigned costs include the long-run incremental costs of a service plus some shared and administrative costs. Contribution is the difference between retail price and long-run incremental cost. The Illinois Commission expects that this methodology, when applied to individual Ameritech services using the carrier's most recently-filed cost studies, will produce an average discount rate of 20.07 percent.<sup>2186</sup> The Illinois Commission applied the same rate to Centel, pending completion by Centel of the cost studies needed to apply the Illinois Commission's adopted methodology.

903. *Louisiana*: The Louisiana Commission established regulations concerning resale of telecommunications services on March 15, 1996.<sup>2187</sup> As an interim measure, until the Louisiana Commission can determine wholesale rates based on TSLRIC cost studies, the commission has set wholesale rates at the incumbent LEC's current tariffed retail rates minus 10 percent. This calculation reflects the incumbent LEC's avoidance of retail costs, including but not limited to, sales, marketing and customer services associated with the resold items.

904. *Maryland*: The Maryland Commission adopted, without analyzing cost studies, an interim discount rate of 10 percent, pending completion of the instant rulemaking proceeding.<sup>2188</sup>

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<sup>2185</sup> *Petition for a Total Local Exchange Wholesale Service Tariff from Illinois Bell Telephone Company*, Nos. 95-0458 and 95-0531 (consol.) (Illinois Commission June 26, 1996).

<sup>2186</sup> The Illinois Commission notes that the pricing methodology that it adopted would yield an average discount of 20.07 percent if applied at the individual service level and 16.63 percent if applied to the "family" service level. *Id.* at 10. Illinois decided that the individual service application avoided certain pricing anomalies and was more consistent with the 1996 Act. *Id.* at 20.

<sup>2187</sup> *In re: Regulations for Competition in the Local Telecommunications Market*, Docket U-200883 (Louisiana Commission March 15, 1996).

<sup>2188</sup> *Wholesale Rates for Telecommunications Services Ruling on AT&T's Petition for a Reduction on the Wholesale Rates of Bell Atlantic-Maryland, Inc.*, Case No. 8721 (Maryland Commission June 27, 1996).

905. *New York*: The New York Commission established temporary wholesale discounts for NYNEX and Rochester Telephone on July 18 of this year.<sup>2189</sup> The New York Commission calculates for NYNEX a 17 percent discount for residential service and an 11 percent discount for business service. Separate avoided cost percentages were derived for different shared expense categories, ranging from five percent for general and administrative expenses to 12.7 percent for network support expense. For marketing categories, 20 percent of product management, 50 percent of sales, and 50 percent of advertising expenses were considered avoidable. All uncollectibles were considered avoidable. Calculating these and other avoided costs, the New York Commission arrived at a 15 percent discount. Because the New York Commission observed that business lines produce higher overall revenue and thus artificially inflate avoided cost for business lines (and undervalue the avoided cost for residential lines), a 17 percent discount was set for residential service while only an 11 percent discount was set for business service. A uniform 13.5 percent discount was ordered for Rochester Telephone, based on a New York Commission analysis of Rochester's 1995 annual report, using principles similar to those applied to NYNEX.

906. *Ohio*: The Ohio Commission has established rules for pricing wholesale services for resale, but has not publicly released calculations of specific discounts for particular services.<sup>2190</sup> The Ohio Commission established a presumption that all expenses contained in the following USOA accounts will be avoided: 5300 (uncollectible revenue), 6611 (product management), 6612 (sales), 6613 (product advertising), 6621 (call completion service), 6622 (number services expense), and 6623 (customer service).<sup>2191</sup> The Ohio Commission's rules require resellers seeking to avoid additional costs to prove that such costs would be avoided in wholesale operations. Beyond the avoided expenses discussed above, the Ohio Commission requires avoided costs to include "direct and indirect costs of all activities eliminated due to the wholesale provisioning."

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<sup>2189</sup> *Joint Complaint of AT&T Communications of New York, Inc., MCI Telecommunications Corporation, WorldCom, Inc. d/b/a LDDS WorldCom and the Empire Association of Long Distance Telephone Companies, Inc. Against New York Telephone Company Concerning Wholesale Provisioning of Local Exchange Service by New York Telephone Company and Sections of New York Telephone's Tariff No. 900*, Case 95-C-0657 (New York Commission July 18, 1996); *Petition of Rochester Telephone Corp. for Approval of a Proposed Restructuring Plan*, Case 93-C-0103 (New York Commission July 18, 1996).

<sup>2190</sup> *Commission Investigation Relative to the Establishment of Local Exchange Competition and Other Competitive Issues*, Case No. 95-845-TP-COI (Ohio Commission June 12, 1996).

<sup>2191</sup> The Ohio Commission also lists account 6610, which is the summary account for marketing expenses (accounts 6611-6613).

## 5. Discussion

907. Resale will be an important entry strategy for many new entrants, especially in the short term when they are building their own facilities. Further, in some areas and for some new entrants, we expect that the resale option will remain an important entry strategy over the longer term. Resale will also be an important entry strategy for small businesses that may lack capital to compete in the local exchange market by purchasing unbundled elements or by building their own networks. In light of the strategic importance of resale to the development of competition, we conclude that it is especially important to promulgate national rules for use by state commissions in setting wholesale rates. For the same reasons discussed in Section II.D of the Order, we believe that we have legal authority under the 1996 Act to articulate principles that will apply to the arbitration or review of wholesale rates. We also believe that articulating such principles will promote expeditious and efficient entry into the local exchange market. Clear resale rules will create incentives for parties to reach agreement on resale arrangements in voluntary negotiations. Clear rules will also aid states in conducting arbitrations that will be administratively workable and will produce results that satisfy the intent of the 1996 Act. The rules we adopt and the determinations we make in this area are crafted to achieve these purposes. We also note that clear resale rules should minimize regulatory burdens and uncertainty for all parties, including small entities and small incumbent LECs.<sup>2192</sup>

908. The statutory pricing standard for wholesale rates requires state commissions to (1) identify what marketing, billing, collection, and other costs will be avoided by incumbent LECs when they provide services at wholesale; and (2) calculate the portion of the retail prices for those services that is attributable to the avoided costs. Our rules provide two methods for making these determinations. The first, and preferred, method requires state commissions to identify and calculate avoided costs based on avoided cost studies. The second method allows states to select, on an interim basis, a discount rate from within a default range of discount rates adopted by this Commission. They may then calculate the portion of a retail price that is attributable to avoided costs by multiplying the retail price by the discount rate.

909. We adopt a minimum set of criteria for avoided cost studies used to determine wholesale discount rates. The record before us demonstrates that avoided cost studies can produce widely varying results, depending in large part upon how the proponent of the study interprets the language of section 252(d)(3). The criteria we adopt are designed to ensure that states apply consistent interpretations of the 1996 Act in setting wholesale rates based on avoided cost studies which should facilitate swift entry by national and regional resellers,

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<sup>2192</sup> See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

which may include small entities.<sup>2193</sup> At the same time, our criteria are intended to leave the state commissions broad latitude in selecting costing methodologies that comport with their own ratemaking practices for retail services. Thus, for example, our rules for identifying avoided costs by USOA expense account are cast as rebuttable presumptions, and we do not adopt as presumptively correct any avoided cost model.

910. Based on the comments filed in this proceeding and on our analysis of state decisions setting wholesale discounts, we adopt a default range of rates that will permit a state commission to select a reasonable default wholesale rate between 17 and 25 percent below retail rate levels. A default wholesale discount rate shall be used if: (1) an avoided cost study that satisfies the criteria we set forth below does not exist; (2) a state commission has not completed its review of such an avoided cost study; or (3) a rate established by a state commission before release of this Order is based on a study that does not comply with the criteria described in the following section. A state commission must establish wholesale rates based on avoided cost studies within a reasonable time from when the default rate was selected. This approach will enable state commissions to complete arbitration proceedings within the statutory time frames even if it is infeasible to conduct full-scale avoided cost studies that comply with the criteria described below for each incumbent LEC.

**a. Criteria for Cost Studies**

911. There has been considerable debate on the record in this proceeding and before the state commissions on whether section 252(d)(3) embodies an "avoided" cost standard or an "avoidable" cost standard. We find that "the portion [of the retail rate] . . . attributable to costs that will be avoided" includes all of the costs that the LEC incurs in maintaining a retail, as opposed to a wholesale, business. In other words, the avoided costs are those that an incumbent LEC would no longer incur if it were to cease retail operations and instead provide all of its services through resellers. Thus, we reject the arguments of incumbent LECs and others who maintain that the LEC must actually experience a reduction in its operating expenses for a cost to be considered "avoided" for purposes of section 252(d)(3). We do not believe that Congress intended to allow incumbent LECs to sustain artificially high wholesale prices by declining to reduce their expenditures to the degree that certain costs are readily avoidable. We therefore interpret the 1996 Act as requiring states to make an objective assessment of what costs are reasonably avoidable when a LEC sells its services wholesale. We note that Colorado, Georgia, Illinois, New York, and Ohio commissions have all interpreted the 1996 Act in this manner.<sup>2194</sup>

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<sup>2193</sup> See *Id.*

<sup>2194</sup> See, e.g., *U S West Communications, Inc. Filing Advice Letter No. 2610 in Compliance with Commission Decision No. C96-521 Adopting Emergency Rules*, Docket No. 96S-233T (Colorado Commission June 21, 1996) at paras. 12-13; *Petition of AT&T for the Commission to Establish Resale Rules, Rates, Terms, and Conditions*

912. We find that, under this "reasonably avoidable" standard discussed above, an avoided cost study must include indirect, or shared, costs as well as direct costs. We agree with MCI, AT&T, and the California, Illinois, Ohio, Colorado, and Georgia commissions that some indirect or shared costs are avoidable and likely to be avoided when a LEC provides retail services to a reseller instead of to the end user. This is because indirect or shared costs, such as general overheads, support all of the LEC's functions, including marketing, sales, billing and collection, and other avoided retail functions. Therefore, a portion of indirect costs must be considered "attributable to costs that will be avoided" pursuant to section 252(d)(3). It is true that expenses recorded in indirect or shared expense accounts will continue to be incurred for wholesale operations. It is also true, however, that the overall level of indirect expenses can reasonably be expected to decrease as a result of a lower level of overall operations resulting from a reduction in retail activity.

913. A portion of contribution, profits, or mark-up may also be considered "attributable to costs that will be avoided"<sup>2195</sup> when services are sold wholesale. MCI's model makes this attribution by means of a calculation that applies the same mark-up to wholesale services as to retail services. The Illinois Commission achieved a similar effect by removing a *pro rata* portion of contribution from the retail rate for each service. In AT&T's model, the portion of return on investment (profits) that was attributable to assets used in avoided retail activities was treated as an avoided cost. We find that these approaches are consistent with the 1996 Act.

914. An avoided cost study may not calculate avoided costs based on non-cost factors or policy arguments, nor may it make disallowances for reasons not provided for in section 252(d)(3). The language of section 252(d)(3) makes no provision for selecting a wholesale discount rate on policy grounds. We therefore reject NCTA's argument that discount rates should be ten percent or less in order to avoid discouraging facilities-based competition, as well as AT&T's suggestion that wholesale discount rates should be set at levels that ensure the viability of the reseller's business. We also reject, for example, MCI's assertion that no external relations or research and development costs should be allowed in wholesale rates

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*and Initiate Unbundling of Services*, Docket No. 6352U (Georgia Commission June 21, 1996); *Petition for a Total Local Exchange Wholesale Service Tariff from Illinois Bell Telephone Company*, Nos. 95-0458 and 95-0531 (consol.) (Illinois Commission June 26, 1996) at 27-34; *Joint Complaint of AT&T Communications of New York, Inc., MCI Telecommunications Corporation, WorldCom, Inc. d/b/a LDDS WorldCom and the Empire Association of Long Distance Telephone Companies, Inc. Against New York Telephone Company Concerning Wholesale Provisioning of Local Exchange Service by New York Telephone Company and Sections of New York Telephone's Tariff No. 900*, Case 95-C-0657 (New York Commission July 18, 1996); *Petition of Rochester Telephone Corp. for Approval of a Proposed Restructuring Plan*, Case 93-C-0103 (New York July 18, 1996); *Commission Investigation Relative to the Establishment of Local Exchange Competition and Other Competitive Issues*, Case No. 95-845-TP-COI (Ohio Commission June 12, 1990) at 30-31.

<sup>2195</sup> 47 U.S.C. § 252(d)(3).

because the activities represented by those costs are contrary to the interests of the LEC competitors that purchase wholesale services.<sup>2196</sup> Our analysis also precludes a state commission from adopting AT&T's suggestion that an increment should be added to the base discount rate to compensate resellers for alleged deficiencies in the provisioning of services.

915. The 1996 Act requires that wholesale rates be based on existing retail rates, and thus clearly precludes use of a "bottom up" TSLRIC study to establish wholesale rates that are not related to the rates for the underlying retail services. We thus reject the suggestions of those parties that ask us to require use of TSLRIC to set wholesale rates. The 1996 Act does not, however, preclude use of TSLRIC cost studies to identify the portion of a retail rate that is attributable to avoided retail costs. TSLRIC studies would be entirely appropriate in states where the retail rates were established using a TSLRIC method. For example, the Illinois Commission calculated its wholesale rate using an avoided cost formula and long run incremental cost studies. Embedded cost studies, such as the studies used by the Georgia Commission, may also be used to identify avoided costs. Ideally, a state would use a study methodology that is consistent with the manner in which it sets retail rates.

916. We neither prohibit nor require use of a single, uniform discount rate for all of an incumbent LEC's services. We recognize that a uniform rate is simple to apply, and avoids the need to allocate avoided costs among services. Therefore, our default wholesale discount is to be applied uniformly. On the other hand, we also agree with parties who observe that avoided costs may, in fact, vary among services. Accordingly, we allow a state to approve nonuniform wholesale discount rates, as long as those rates are set on the basis of an avoided cost study that includes a demonstration of the percentage of avoided costs that is attributable to each service or group of services.

917. All costs recorded in accounts 6611 (product management), 6612 (sales), 6613 (product advertising) and 6623 (customer services) are presumed to be avoidable. The costs in these accounts are the direct costs of serving customers. All costs recorded in accounts 6621 (call completion services) and 6622 (number services) are also presumed avoidable, because resellers have stated they will either provide these services themselves or contract for them separately from the LEC or from third parties. These presumptions regarding accounts 6611-6613 and 6621-6623 may be rebutted if an incumbent LEC proves to the state commission that specific costs in these accounts will be incurred with respect to services sold at wholesale, or that costs in these accounts are not included in the retail prices of the resold services.

918. General support expenses (accounts 6121-6124), corporate operations expenses (accounts 6711, 6612, 6721-6728), and telecommunications uncollectibles (account 5301) are presumed to be avoided in proportion to the avoided direct expenses identified in the previous

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<sup>2196</sup> See MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 6-7.

paragraph. Expenses recorded in these accounts are tied to the overall level of operations in which an incumbent LEC engages. Because the advent of wholesale operations will reduce the overall level of operations -- for example, staffing should decrease because customer inquiries and billing and collection activity will decrease -- overhead and support expenses are in part avoided. We select the revenue offset account of 5301 rather than accounts 5300 or 6790 because account 5301 most directly represents overheads attributable to the services being resold.

919. Plant-specific and plant non-specific expenses (other than general support expenses) are presumptively not avoidable.

920. In the case of carriers designated as Class B under section 32.11 of our rules that use certain summary accounts in lieu of accounts designated in this subsection of the Order, our avoided cost study criteria shall apply to the relevant summary account in its entirety.<sup>2197</sup>

**b. Default Range of Wholesale Discount Rates**

921. Parties to this proceeding present evidence or arguments supporting wholesale discount rates ranging from 4.76 percent to 55 percent:

Sprint/United Telephone study	
Simple Access service:	4.76%
Other services:	7.19%
NCTA	10.0%
Comcast	10.0%
Massachusetts Attorney General	25.0%
ACTA	25.0%
MCI Model	25.6-33.2% <sup>2198</sup>
Telecommunications Resellers Ass'n	30.0-50.0%
AT&T Model	23.05%-55.52% <sup>2199</sup>

<sup>2197</sup> See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

<sup>2198</sup> MCI calculated rates based on actual accounting data for the years 1990-1995 for each RBOC and for GTE. For 1995 the rates ranged from 25.6 percent for U S West to 33.2 percent for Ameritech. MCI also calculates rates for 1996 using estimated data. MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 1.

<sup>2199</sup> AT&T calculated separate discount rates for each RBOC study area and for SNET and GTE Hawaiian Tel.

922. States applying wholesale pricing standards similar to the standards in section 252(d)(3) have set the following wholesale discounts:

**California****PacTel**

Business	17.0%
Residential	10.0%

**GTE**

Business	12.0%
Residential	7.0%

**Colorado**

Residential	9.0%
Business	16.0%
Toll Services	30.0%
Central Office-Based Features	50.0% <sup>2200</sup>
All other services	18.0%

**Georgia**

Residential	20.3%
Business	17.3%

Illinois 20.07%<sup>2201</sup>

**New York****NYNEX**

Business	17.0%
Residential	11.0%

Rochester Telephone 13.5%

923. We find unpersuasive various arguments presented by parties at the lower and higher ends of the range of possible discounts. The Sprint/United Telephone study produces unreasonably low measures of avoided costs because the study considers only avoided direct

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<sup>2200</sup> Central office-based services are custom calling features such as speed dialing and CLASS features, such as caller ID. *U S West Communications, Inc. Filing Advice Letter No. 2610 in Compliance with Commission Decision No. C96-521 Adopting Emergency Rules*, Docket No. 96S-233T (Colorado Commission June 21, 1996) at para. 13.

<sup>2201</sup> The Illinois Commission requires wholesale discounts to be computed on a service-specific basis. The 20.07 percent figure represents an "average" discount using such a methodology.

expenses in five accounts. As explained above, we interpret the statutory language providing for a wholesale price that excludes the "portion [of a retail rate] attributable to any marketing, billing, collection, and other costs that will be avoided"<sup>2202</sup> to include indirect as well as direct costs. The proposals of NCTA and Comcast for a maximum discount of 10 percent are premised on the view that any greater discount would unduly discourage facilities-based competition. Section 252(d)(3), however, requires wholesale prices to be set based on avoided costs, not on any policy preference for facilities-based competition. For the same statutory reason, we reject as inconsistent with section 252(d)(3) the policy arguments of the Telecommunications Resellers Association and AT&T that we should establish national wholesale discounts at levels that will ensure that resale of local exchange services is a viable business.<sup>2203</sup>

924. We find AT&T's model unsuitable for purposes of establishing in this proceeding a range for default wholesale discount rates. The AT&T model does in many respects satisfy the general criteria we establish above for avoided cost studies. The model, however, incorporates numerous assumptions, cost allocation factors, and studies, and because AT&T submitted its model with its reply comments, and other parties have not analyzed the model in detail. We find that we would need to develop a more complete record on the AT&T model before deciding whether to endorse it. We do not, however, preclude a state commission from considering in a wholesale rate proceeding evidence developed using this model.

925. We find that we can use MCI's model, with some modifications, along with the results of certain state proceedings, to establish a range of rates that would produce an acceptable default wholesale discount rate that reasonably approximates the amount of avoided costs that should be subtracted from the retail rate. A default rate is to be used only in three instances: (1) in a state arbitration proceeding if an avoided cost study that satisfies the criteria we set forth above does not exist; (2) where a state has not completed its review of such an avoided cost study; (3) where a rate established by a state before the release date of this Order is based on a study that does not comply with the criteria described in the previous section. We emphasize that the default rate is to be used as an interim measure only, and should be replaced with an avoided cost study within a reasonable time. The MCI model is a reasonable attempt at estimating avoided cost in accordance with section 252(d)(3) using only publicly-available data. We find, however, that we should modify certain features of the model.

926. First, MCI treats account 6722 (external relations) and account 6727 (research and development) as avoidable costs. MCI argues that purchasers of wholesale services are

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<sup>2202</sup> 47 U.S.C. § 252(d)(3).

<sup>2203</sup> See AT&T comments at 81-86; Telecommunications Resellers Ass'n comments at 24.

competing with LECs and, therefore, should not be forced to fund regulatory activities reflected in account 6722. MCI claims that research and development are not of practical use for the services that resellers will purchase. As explained above, this type of disallowance is not contemplated by the avoided cost standard of section 252(d)(3). We therefore adjust the model to treat these costs in the same manner as other overhead expense accounts.

927. Second, MCI treats a number of accounts as "other avoided costs" on the grounds that the expenses in those accounts are not relevant to the provision of telecommunications services that an incumbent LEC currently provides.<sup>2204</sup> Public telephone terminal equipment expense and large PBX expense are not "avoided" precisely because they are unrelated to the retail services being discounted. We would not expect these expenses to be included in retail service rates for resold services; but if these expenses were included in retail rates, they would not be avoided when the services are purchased by resellers. The rest of MCI's "other" accounts contain costs that support all of the telecommunications services offered by the company. MCI has not shown that any of these costs are either reduced or eliminated when services are sold at wholesale. We, therefore, adjust the MCI model so as not to treat these accounts as avoidable costs.

928. Third, MCI treats accounts 6611 (product management), 6612 (sales), 6613 (product advertising), and 6623 (customer services) as costs that are entirely avoided with respect to services purchased at wholesale. We agree that a large portion of the expenses in these accounts is avoided when service is sold at wholesale. We also agree, however, with parties that argue that some expenses in these accounts will continue to be incurred with respect to wholesale products and customers, and that some new expenses may be incurred in addressing the needs of resellers as customers. No party in this proceeding has suggested a specific adjustment to the MCI model that would account for these costs of the wholesale operation. We note that, in their own proceedings, several states have made varying estimates concerning the level of wholesale-related expenses in these accounts. Colorado, for example, estimated that none of the costs in accounts 6611-6613 would relate to wholesale services, and that only five percent of the costs in account 6623 would be incurred in a wholesale operation.<sup>2205</sup> The Georgia Commission, on the other hand, decided that 25 percent of sales

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<sup>2204</sup> Based on this rationale, MCI excludes account 6113 (aircraft expense), account 6341 (large PBX expense), account 6511 (property held for future telecommunications use expense), account 6351 (public telephone terminal equipment expense), account 6512 (provisioning expense), account 6562 (depreciation expense for property held for future telecommunications use), and account 6564 (amortization expense, intangible).

<sup>2205</sup> *U S West Communications, Inc. Filing Advice Letter No. 2610 in Compliance with Commission Decision No. C96-521 Adopting Emergency Rules*, Docket No. 96S-233T (Colorado Commission June 21, 1996) at para. 12 and n.20. The Colorado Commission explained that it chose 5 percent because "some small portion of customer services will remain for the interfaces of Operational Support Systems of [U S West] and the resellers, but nowhere near the amount necessary for direct customer contact services." *Id.* n.20.

and product advertising expenses would continue to be incurred in the wholesale operation.<sup>2206</sup> Given the lack of evidence, and the wide range of estimates that have been made by these states, we find it reasonable to assume, for purposes of determining a default range of wholesale discount rates, that ten percent of costs in accounts 6611, 6612, 6613, and 6623 are not avoided by selling services at wholesale.

929. Fourth, MCI uses a complex formula to calculate the portions of overhead and general support expense that are attributable to avoided costs. We find that this formula is constructed in a way that tends to inflate the results of the calculation. We have, therefore, substituted a more straightforward approach in which we apply to each indirect expense category the ratio of avoided direct expense to total expenses. We also identify a slightly different list of accounts representing indirect costs than that proposed by MCI.

930. With the modifications described above, and using actual 1995 data, MCI's model produces the following results for the RBOCs and GTE:

U S West	18.80%
GTE	18.81%
BellSouth	19.20%
Bell Atlantic	19.99%
SBC	20.11%
NYNEX	21.31%
Pacific	23.87%
Ameritech	25.98%

931. We also take into account the experience of those state commissions, Illinois and Georgia, that have undertaken or approved detailed avoided cost studies under the pricing standard of section 252(d)(3) of the 1996 Act. Applying the statutory standard to the examination of significant cost studies, those commissions derived average wholesale discounts of 18.74 percent<sup>2207</sup> and 20.07 percent. We find that these decisions present evidence of an appropriate wholesale discount that should be given more weight than state

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<sup>2206</sup> *Petition of AT&T for the Commission to Establish Resale Rules, Rates, Terms, and Conditions and Initiate Unbundling of Services*, Docket No. 6352U (Georgia Commission June 21, 1996) at Appendix 1. The Georgia Commission characterized its calculations with respect to sales expense as "conservative at best."

<sup>2207</sup> Prior to apportioning avoided costs between business and residential services, the Georgia Commission's avoided cost computation would have yielded an aggregate wholesale discount rate of 18.74 percent. This figure is computed by dividing the total avoided costs computed by the Georgia Commission by the total BellSouth residential and business revenues (which were used individually both to apportion total avoided costs between residential and business service and as the denominator in the final wholesale discount calculations).

commission decisions that have set their discounts under other pricing standards or only on an interim basis.<sup>2208</sup>

932. Accordingly, based on the record before us, we establish a range of default discounts of 17-25 percent that is to be used in the absence of an avoided cost study that meets the criteria set forth above. A state commission that has not set wholesale prices based on avoided cost studies that meet the criteria set forth above as of the release date of this Order shall use a default wholesale discount rate between 17 and 25 percent. A state should articulate the basis for selecting a particular discount rate. If this default discount rate is used, the state commission must establish wholesale rates based on avoided cost studies within a reasonable time. The avoided cost study must comply with the criteria for avoided cost studies described above. A state commission may submit an avoided cost study to this Commission for a determination of whether it complies with these criteria. If a party (either a reseller or an incumbent LEC) believes that a state commission has failed to act within a reasonable period of time, that party may file a petition for declaratory ruling with this Commission, asking us to determine whether the state has failed to comply with this rule. We will, in making such determinations, consider the particular circumstances in the state involved. If a state commission has adopted as of the release date of this Order an interim wholesale pricing decision that relies on an avoided cost study that meets the criteria set forth above, the state commission may continue to require an incumbent LEC to offer services for resale under such interim wholesale prices in lieu of the default discount range, so long as the state commission's interim pricing rules are fully enforceable by resellers and followed by a final decision within a reasonable period of time that adopts an avoided cost study that meets the criteria set forth above.

933. We select the 17 to 25 percent range of default discounts based on our evaluation of the record. The adjusted results of the MCI model taken together with the results of those state proceedings discussed above that indicated they applied the statutory standard produces, a range between 18.74 and 25.98 percent. A majority of these wholesale discount rates fall between 18.74 and 21.11 percent. Other state commissions, such as California and New York, that have employed avoided cost studies have produced wholesale discount rates somewhat below the low end of this range. Furthermore, it has been argued that smaller incumbent LECs' avoided costs are likely to be less than those of the larger incumbent LECs, whose data was used by MCI. Therefore, to allow for these considerations,

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<sup>2208</sup> See, e.g., *Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service*, R. 95-04-043 and I. 95-04-044 (California Commission April 26, 1996); *U S West Communications, Inc. Filing Advice Letter No. 2610 in Compliance with Commission Decision No. C96-521 Adopting Emergency Rules*, Docket No. 96S-233T (Colorado Commission June 21, 1996); *Wholesale Rates for Telecommunications Services Ruling on AT&T's Petition for a Reduction on the Wholesale Rates of Bell Atlantic-Maryland, Inc.*, Case No. 8721 (Maryland Commission June 27, 1996).

we select 17 percent as the lower end of the range.<sup>2209</sup> We select 25 percent as the top of the range because it approximates the top of the range of results produced by the modified MCI model. This range gives state commissions flexibility in addressing circumstances of incumbent LECs serving their states and permits resale to proceed until such time as the state commission can review a fully-compliant avoided cost study.

934. We have considered the economic impact of our rules in this section on small incumbent LECs. For example, Bay Springs, *et al.*, argues that national wholesale pricing rules will insufficiently consider operational differences between small and large incumbent LECs.<sup>2210</sup> We take this into consideration in setting the default discount rate and in requiring state commissions to perform carrier-specific avoided cost studies within a reasonable period of time that will reflect carrier-to-carrier differences. We believe, however, that the procompetitive goals of the 1996 Act require us to establish a default discount rate for state commissions to use in the absence of avoided cost studies that comply with the criteria we set forth above. The presumptions we establish in conducting avoided cost studies regarding the avoidability of certain expenses may be rebutted by evidence that certain costs are not avoided, which should minimize any economic impact of our decisions on small incumbent LECs. We also note that certain small incumbent LECs are not subject to our rules under section 251(f)(1) of the 1996 Act, unless otherwise determined by a state commission, and certain other small incumbent LECs may seek relief from their state commissions from our rules under section 251(f)(2) of the 1996 Act.

### C. Conditions and Limitations

935. Section 251(c)(4) requires incumbent LECs to make their services available for resale without unreasonable or discriminatory conditions or limitations. This portion of this Order addresses various issues relating to conditions or limitations on resale. It first discusses restrictions, generally, in Section VIII.C.1. Next, it turns to promotional and discounted offerings and the conditions that may attach to such offerings in Section VIII.C.2., and then to refusals to resell residential and below-cost services in Section VIII.C.3. Limitations on the categories of customers to whom a reseller may sell incumbent LEC services are discussed in VIII.C.4. Resale restrictions in the form of withdrawal of service are discussed in VIII.C.5. Finally, Section VIII.C.6. discusses resale restrictions relating to provisioning.

#### 1. Restrictions, Generally, and Burden of Proof

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<sup>2209</sup> See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

<sup>2210</sup> Bay Springs, *et al.*, comments at 17.

**a. Background and Comments**

936. In the NPRM, we asked whether incumbent LECs should have the burden of proving that restrictions on resale are reasonable and nondiscriminatory.<sup>2211</sup> We stated our belief that, given the pro-competitive goals of the 1996 Act and the view that restrictions and conditions were likely to be evidence of an exercise of market power, the range of permissible restrictions should be quite narrow.<sup>2212</sup>

937. A number of parties, including IXC's, resellers, and some state commissions, agree that incumbent LECs should have the burden of justifying any restrictions they impose on the resale of their services.<sup>2213</sup> For example, Jones Intercable proposes a requirement that incumbent LECs prove that a proposed condition or restriction will directly advance an important public policy objective and that the benefits of the condition plainly outweigh its anticompetitive effects.<sup>2214</sup> Many add the caveat that the only permissible restriction should be the cross-class restriction, section 251(c)(4)(B), prohibiting resellers that obtain at wholesale rates telecommunications services that are available at retail only to a category of subscribers from offering such services to a different category of subscribers.<sup>2215</sup> The Texas Public Utility Counsel suggests that the relevant determination is whether an incumbent LEC could impose the condition in question in a competitive market.<sup>2216</sup>

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<sup>2211</sup> NPRM at para. 175.

<sup>2212</sup> *Id.*

<sup>2213</sup> See, e.g., ACSI comments at 60; California Commission comments at 35-37; CFA/CU comments at 17; Citizens Utilities comments at 27; Colorado Commission comments at 52-53; Jones Intercable comments at 24; MFS comments at 70; NEXTLINK comments at 30; Pennsylvania Commission comments at 36; Ohio Commission comments at 62; TCC comments at 43; Telecommunications Resellers Ass'n comments at 20; Washington Commission comments at 32.

<sup>2214</sup> Jones Intercable comments at 32-33.

<sup>2215</sup> See, e.g., CFA/CU comments at 17; Citizens Utilities at 27; Colorado Commission comments at 52-53; TCC comments at 43. Many of these parties offer a narrow interpretation of section 251(c)(4)(B), which will be discussed, *infra*.

<sup>2216</sup> Texas Public Utilities Counsel reply at 42.

938. Incumbent LECs support various restrictions and limitations.<sup>2217</sup> BellSouth and the Ohio Consumers' Counsel further suggest that the burden of justifying restrictions and limitations should not be placed on LECs.<sup>2218</sup>

**b. Discussion**

939. We conclude that resale restrictions are presumptively unreasonable. Incumbent LECs can rebut this presumption, but only if the restrictions are narrowly tailored. Such resale restrictions are not limited to those found in the resale agreement. They include conditions and limitations contained in the incumbent LEC's underlying tariff. As we explained in the NPRM, the ability of incumbent LECs to impose resale restrictions and conditions is likely to be evidence of market power and may reflect an attempt by incumbent LECs to preserve their market position. In a competitive market, an individual seller (an incumbent LEC) would not be able to impose significant restrictions and conditions on buyers because such buyers turn to other sellers. Recognizing that incumbent LECs possess market power, Congress prohibited unreasonable restrictions and conditions on resale. We, as well as state commissions, are unable to predict every potential restriction or limitation an incumbent LEC may seek to impose on a reseller. Given the probability that restrictions and conditions may have anticompetitive results, we conclude that it is consistent with the procompetitive goals of the 1996 Act to presume resale restrictions and conditions to be unreasonable and therefore in violation of section 251(c)(4). This presumption should reduce unnecessary burdens on resellers seeking to enter local exchange markets, which may include small entities, by reducing the time and expense of proving affirmatively that such restrictions are unreasonable.<sup>2219</sup> We discuss several specific restrictions below including certain restrictions for which we conclude the presumption of unreasonableness shall not apply. We also discuss certain restrictions that we will presume are reasonable.

**2. Promotions and Discounts**

**a. Background and Comments**

940. In the NPRM, we asked whether an incumbent LEC's obligation to make their services available for resale at wholesale rates applies to discounted and promotional offerings and, if so, how.<sup>2220</sup> We also asked, if the wholesale pricing obligation applies to promotions

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<sup>2217</sup> See, e.g., BellSouth comments at 66.

<sup>2218</sup> BellSouth comments at 65; Ohio Consumers' Counsel comments at 35.

<sup>2219</sup> See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

<sup>2220</sup> NPRM at para. 175.

and discounts, whether the reseller entrant's customer must take service pursuant to the same restrictions that apply to the incumbent LEC's retail customers.<sup>2221</sup>

941. Incumbent LECs and Time Warner argue that they should not be required to offer discounted and promotional offerings at wholesale rates.<sup>2222</sup> These parties argue that promotions and discounts are merely subsets of standard offerings, or that promotions and discounts are only devices for marketing underlying "telecommunications services."<sup>2223</sup> Thus, these parties argue, a discounted and promotional offering is not in itself a "telecommunications service" that is subject to the resale requirement as long as the standard offering is made available for resale at wholesale rates.<sup>2224</sup>

942. Incumbent LECs argue that requiring promotions and discounts to be made available at wholesale rates will discourage such offerings. According to incumbent LECs, promotions and discounts serve as a means by which incumbent LECs differentiate their services from resellers' offerings.<sup>2225</sup> Furthermore, they contend that establishing a system where resellers' service and pricing options track incumbent LECs' promotions and discounts would promote collusion rather than competition.<sup>2226</sup> SBC notes that resellers will have access to volume discounts (through aggregating) that will allow them to compete with promotions and discounts offered by incumbent LECs.<sup>2227</sup> Incumbent LECs argue that many promotions, such as offering installation at no charge for new customers for limited periods, are short-term and used as marketing tools.<sup>2228</sup> Some parties suggest that the wholesale rate obligation

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<sup>2221</sup> *Id.*

<sup>2222</sup> See, e.g., Ameritech comments at 57; Bell Atlantic comments at 46; MECA comments at 60; NYNEX comments at 76; SNET comments at 34; Time Warner comments at 73; U S West comments at 67; USTA comments at 72. Some parties commented only with respect to promotional offerings. See, e.g., BellSouth comments at 66; Cincinnati Bell comments at 34; PacTel comments at 87; SBC comments at 72.

<sup>2223</sup> See, e.g., Ameritech comments at 57; NYNEX comments at 76.

<sup>2224</sup> See, e.g., Bell Atlantic reply at 23-24; GTE comments at 50; MECA comments at 60; NYNEX comments at 76; Time Warner comments at 73.

<sup>2225</sup> See, e.g., BellSouth comments at Attachment (Interconnection and Economic Efficiency), p. 22; Cincinnati Bell comments at 33; USTA comments at Attachment (Affidavit of Jerry Hausman), p. 14.

<sup>2226</sup> GTE comments at 50.

<sup>2227</sup> SBC comments at 72-73.

<sup>2228</sup> See, e.g., NYNEX comments at 76 (promotions are merely short term waivers of nonrecurring charges).

should, at least, not attach to offerings that are only available for a limited period of time.<sup>2229</sup> Specifically, some parties recommend that we not permit incumbent LECs not to offer wholesale rates for offerings that are only available for 120 days or less.<sup>2230</sup>

943. Some parties also contend that section 251(c)(4) resale obligations should not apply to contract,<sup>2231</sup> trial,<sup>2232</sup> or community service offerings.<sup>2233</sup> GTE and U S West argue that high volume rate offerings should not be subject to the wholesale rate obligation because they are already discounted.<sup>2234</sup> Ameritech and Bell Atlantic argue that contract offerings are not subject to resale because they are not made generally available.<sup>2235</sup>

944. IXCs, resellers, and DoJ argue that if incumbent LECs are not required to offer promotions and other discounts at wholesale rates, incumbent LECs will be able to undercut rates that resellers offer.<sup>2236</sup> They contend that services, classes of customers, or even individual customers could be strategically targeted by the incumbent LECs.<sup>2237</sup> The Telecommunications Resellers Association and others argue that price reductions that are designed to drive competitors from the market do not produce long-term gains for consumers.<sup>2238</sup> The Ohio Consumers' Counsel argues that, if the Commission were to exempt

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<sup>2229</sup> Ameritech comments at 56-57; GTE reply at 27 n.49; Ohio Consumer's Counsel comments at 36; PacTel reply at 45.

<sup>2230</sup> See, e.g., Ameritech comments at 57.

<sup>2231</sup> BellSouth comments at 66; USTA comments at 72.

<sup>2232</sup> Bell Atlantic reply at 23-24; SBC comments at 71; USTA comments at 72.

<sup>2233</sup> J. Staurulakis comments at 7. LDDS advocates that resale of community service offerings be limited to the class of subscribers eligible to receive such offerings. LDDS comments at 84.

<sup>2234</sup> GTE comments at 49-50; U S West comments at 68.

<sup>2235</sup> Ameritech reply at 47; Bell Atlantic reply at 24.

<sup>2236</sup> See, e.g., AT&T comments at 83; Cable & Wireless comments at 37; Telecommunications Resellers Ass'n reply at 13; DoJ comments at 54-55. For this reason, the Washington Commission made its support of promotional and discount resale restrictions contingent on rules that would prevent incumbent LECs from pricing such offerings below rates offered to resellers. Washington Commission comments at 32.

<sup>2237</sup> See, e.g., Telecommunications Resellers Ass'n reply at 13.

<sup>2238</sup> Telecommunications Resellers Ass'n reply at 13.